Good practice note on improving the quality of local authority annual accounts

Expenditure and funding analysis

AUDIT SCOTLAND

Prepared for councils and appointed auditors

9 May 2018

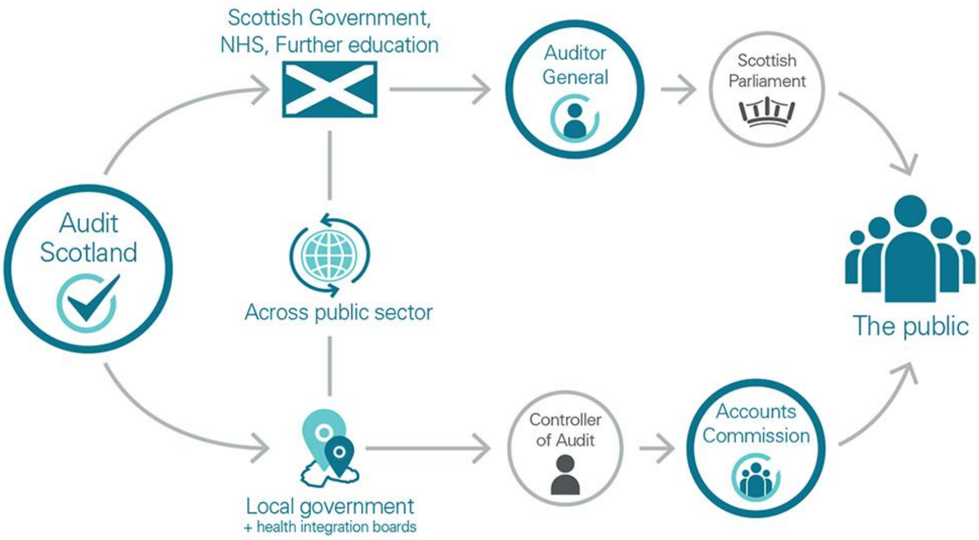
Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.

- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.

- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money

- reporting our findings and conclusions in public

- identifying risks, making clear and relevant recommendations.

Contents

Key messages

Purpose, prominence and format of the EFA

1. A clear description of the purpose of the EFA that is specific to the council should be provided.
2. The format of the EFA should clearly demonstrate the difference between net expenditure on each operating segment on a funding basis compared with an accounting basis.
3. The number of operating segments reported should not be excessive.
4. The EFA should be disclosed in a prominent position within the notes.

Supporting disclosures and narrative

5. The description of adjustments between a funding basis and accounting basis should be supported by narrative explanation.
6. The total adjustments should be consistent with the total adjustments reported elsewhere in the annual accounts, or an explanation for the difference should be disclosed.
7. The EFA should provide a bridge between the information in the management commentary and the figures in the financial statements.

Other segmental reporting disclosures

8. A subjective analysis of income and expenditure should be disclosed.
9. Service income analysed by operating segment should be disclosed.

Introduction

Purpose

1. Audit Scotland promotes good practice in financial reporting in Scottish public bodies. Audit Scotland's Professional Support carries out reviews of annual accounts to identify and share examples of good practice reporting and highlight areas where improvements can be made.

2. This good practice note shares the findings from a review of expenditure and funding analysis (EFA) disclosures in the 2016/17 annual accounts of Scotland's 32 councils. It also applies to other local authority bodies that are required to disclose an EFA.

3. Local authorities are encouraged to use the findings in this good practice note to assess and enhance their own disclosures to ensure they provide high quality information to stakeholders in their annual accounts. A checklist that may help in this regard is provided at Appendix 1.

Local authorities should use this good practice note to assess and enhance their own EFA disclosures.

Context

4. Councils are required to prepare their annual accounts in accordance with proper accounting practice as set out in section 12 of the Local Government in Scotland Act 2003. This includes compliance with the Code of Practice on Local Authority Accounting in the United Kingdom issued by CIPFA/LASAAC (the accounting code).

5. The accounting code includes a requirement for an EFA to demonstrate how the funding available to the authority has been used in providing services, in comparison with those resources consumed or earned by the authority in accordance with generally accepted accounting practices.

6. The EFA disclosures were chosen for good practice review as 2016/17 was the first year of the requirement. This good practice note discusses and highlights some of the good practice adopted by councils. The note also includes recommendations to assist all councils achieve good practice.

7. The audit of the 2016/17 annual accounts of each council was carried out by appointed external auditors, and was concerned with expressing opinions on whether the accounts were prepared in accordance with these proper accounting practices. As there were no qualified opinions, there is reasonable assurance that minimum disclosure requirements were met. However, it should not be inferred that there is no scope for councils to improve the quality of their EFA disclosures.

Unqualified audit opinions do not mean there is no scope for improving the quality of disclosures

Rationale for EFA

8. The EFA was introduced to help councils explain the differences between their financial performance on a funding basis and the surplus or deficit on the provision of services in the comprehensive income and expenditure statement (CIES).

9. The way that councils report performance internally on a funding basis is founded in legislation, and reflects the resources available to them to meet their expenses. This differs from the way councils report

The EFA explains the difference between financial performance on a funding basis and accounting basis.

performance within their financial statements which is in line with international financial reporting standards (IFRS).

10. IFRS require financial performance to be reported inclusive of gains and losses relating to the changes in value of assets and liabilities; these do not generally impact immediately or directly on the funding available.

Characteristics of good annual accounts

11. Beyond basic compliance with proper accounting practices, there are nine characteristics of financial reporting which Professional Support believe make for good annual accounts. These characteristics are summarised in Exhibit 1.

Exhibit 1

These characteristics are based on those used by the Financial Reporting Council adapted for the public sector context.

12. Appendix 2 provides further information on the characteristics. This good practice note discusses and highlights the extent to which EFA disclosures met these characteristics. The note also includes recommendations to assist all IJBs achieve good practice.

The examples used in this note are all taken from councils' 2016/17 annual accounts.

Contact points

13. The contact points for this good practice note are Paul O'Brien, Senior Manager (Professional Support) - 0131 625 1795 or Tim Bridle, Manager (Professional Support) - 0131 625 1793.

Part 1
Purpose, prominence and format of the EFA

Key messages

A clear description of the purpose of the EFA that is specific to the council should be provided.

The format of the EFA should clearly demonstrate the difference between net expenditure on each operating segment on a funding basis compared with an accounting basis.

The number of operating segments reported should not be excessive.

The EFA should be disclosed in a prominent position within the notes.

Description of purpose

14. Councils are required to include a description of the purpose of the EFA in the financial statements, and the accounting code provides recommended wording. All but one council provided a description in 2016/17. Exhibit 2 provides an example of clear and concise wording:

Exhibit 2

NOTES TO THE FINANCIAL STATEMENTS

2. Expenditure and Funding Analysis - Council

The objective of the Expenditure and Funding Analysis is to demonstrate to council tax and rent payers how the funding available to the authority (i.e. government grants, rents, fees and charges, council tax and business rates) for the year has been used in providing services in comparison with those resources consumed or earned by authorities in accordance with generally accepted accounting practices. The Expenditure and Funding Analysis also shows how this expenditure is allocated for decision making purposes between the Council's services. Income and expenditure accounted for under generally accepted accounting practices is presented more fully in the Comprehensive Income and Expenditure Statement on Page 21.

15. Some councils followed the recommended wording, while others used wording from the consultation draft of the 2016/17 accounting code which is perhaps less clear. However, councils did not always tailor the wording it to their own circumstances, e.g. they retained the wording ‘directorates/services/departments’ rather than replacing it with their own relevant terminology. Although minor, this could indicate to users that the council has not thought much about the wording.

Most councils provided a description for the EFA but did not always make it specific.

Tailor the description of the EFA so that it is specific to the council.

Format of the EFA

Councils generally used a three column format for the EFA.

16. The accounting code requires the EFA to include three columns and sets out what each column should present:

- Column I shows the net expenditure chargeable to the general fund analysed by service segment.
- Column II shows adjustments that add expenditure or income not chargeable to council tax or rents and remove transactions which are only chargeable under statutory provisions.
- Column III shows the amounts for each line in column I after the adjustments in Column II, which equal the net expenditure in the equivalent lines in the CIES (with a single aggregated line for other income and expenditure).

17. Most councils followed the three column format. Exhibit 3 provides an example.

Exhibit 3

2015-2016				2016-2017		
Net expenditure chargeable to the General Fund and HRA Balances	Adjustments between the funding and accounting basis (Note 6)	Net expenditure in the comprehensive income and expenditure statement		Net expenditure chargeable to the General Fund and HRA Balances	Adjustments between the funding and accounting basis (Note 6)	Net expenditure in the comprehensive income and expenditure statement
£m	£m	£m		£m	£m	£m
151.526	20.673	172.199	Children's Services	162.104	12.350	174.454
51.053	9.489	60.542	Community Resources	51.088	9.227	60.315
12.075	1.212	13.287	Development & Housing Services	14.059	(1.507)	12.552
0.407	8.811	9.218	Housing services - Housing Revenue Account	0.428	7.039	7.467
32.060	3.152	35.212	Finance & Resources	32.905	4.217	37.122
3.841	-	3.841	Chief Executive's Service	6.897	-	6.897
58.169	(54.443)	3.726	Other Services	48.585	(52.110)	(3.525)
9.366	2.626	11.992	Leisure Services	9.204	2.575	11.779
60.229	3.596	63.825	Adult Services	60.824	1.466	62.290
378.726	**(4.884)**	**373.842**	**Net cost of services**	**386.094**	**(16.743)**	**369.351**
(380.844)	3.004	(377.840)	Other income and expenditure	(373.014)	2.897	(370.117)
(2.118)	**(1.880)**	**(3.998)**	**(Surplus) or deficit**	**13.080**	**(13.846)**	**(0.766)**

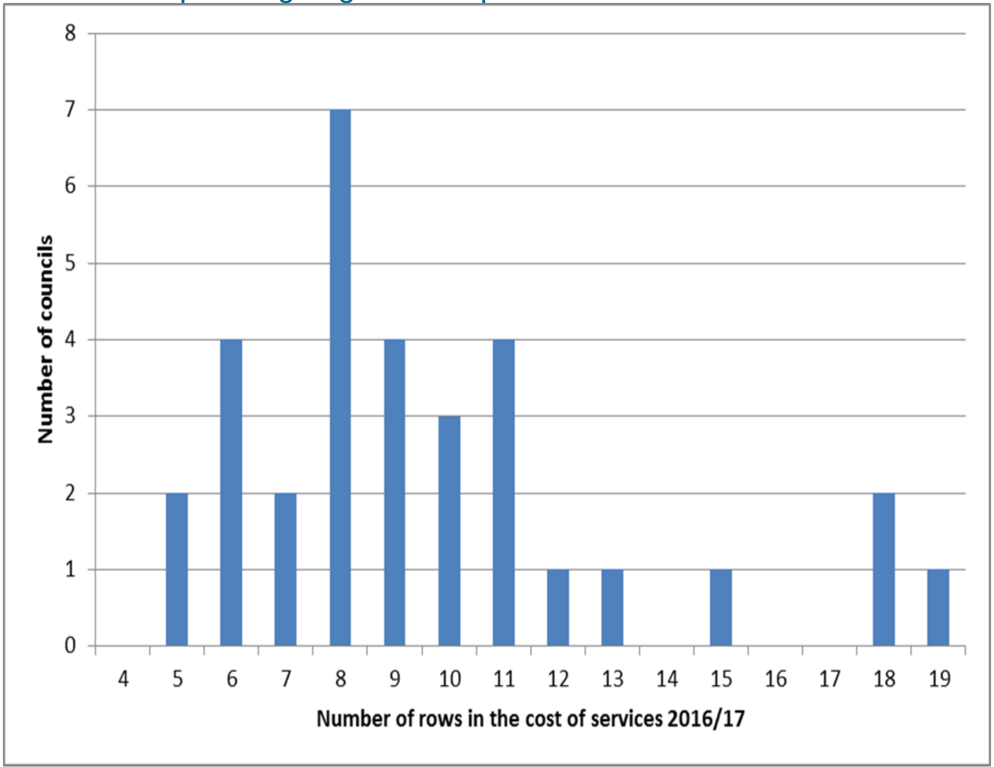
Segmental analysis

18. Councils are required to analyse their service segments in the EFA on the basis of the organisational structure under which they operate (e.g. departments, directorates and portfolios). Reportable operating segments should be based on a council's internal management reporting used to assess service performance when considering the allocation of financial resources.

19. The number of reported operating segments in 2016/17 varied widely between councils as shown in Exhibit 4.

Exhibit 4

Number of operating segments reported in 2016/17



Source: Audit Scotland

The number of reported segments ranged from 5 to 19.

20. The highest number of operating segments was 19, and ten councils reported more than ten segments. These councils should consider whether this is excessive, particularly in light of the amendment to the 2018/19 accounting code which indicates that ten is a practical limit.

21. Councils have some discretion over how many operating segments they report. Where income and expenditure is less than 10% of the total, segments can be amalgamated.

Report segments at an appropriate level of aggregation.

Elimination of recharges

22. The EFA is required to meet the segmental reporting requirements of IFRS 8 Operating Segments. This may involve net expenditure including internal recharges which are part of a service manager's 'controllable budget'.

The EFA may include internal recharges.

23. Seven councils included a separate line at the bottom of columns I and III in the 2016/17 EFA to eliminate the internal recharges included in the segment lines. This matched the treatment of internal recharges in the CIES. This approach is considered to require a sub-total to be provided showing total income and expenditure before the elimination line as this more clearly demonstrates compliance with IFRS 8. However, councils did not include a sub-total in 2016/17.

24. An alternative to the above, would be to use column 2 to remove the internal recharges from each segment. This is explicitly allowed by the 2018/19 accounting code.

Where internal recharges are eliminated, include a subtotal in the EFA for segmental income and expenditure.

Movement in reserves analysis

25. The accounting code also requires the movement (including opening and closing balances) on the general fund to be disclosed at the foot of the EFA. All but one council made the disclosure in 2016/17. Exhibit 5 provides an example of the disclosure.

Exhibit 5

(18,991)	**Opening General Fund Balance**	(23,163)	
(4,172)	Less/Plus (Surplus) or Deficit on General Fund	4,869	
(23,163)	**Closing General Fund as 31 March**	(18,294)	

26. The accounting code also requires the balances to be analysed between the general fund and housing revenue account (HRA) where the council has one. It gives councils the option to either disclose the analysis at the foot of the EFA or to make a cross-reference to the same balances in the movement in reserves statement (MIRS).

27. Of the 26 councils with an HRA, 16 disclosed the required analysis. Four disclosed the analysis at the foot of the EFA, while twelve cross-referred. The advantage of using a cross-reference is it makes the disclosure shorter. Exhibit 6 provides an example of both approaches:

Exhibit 6

Total General Fund and HRA		General Fund	HRA	Total General Fund and HRA
(28,122)	Opening General Fund and HRA Balance	(32,967)	(12,545)	(45,512)
(12,734)	Less/plus Surplus or Deficit on General Fund	(20,027)	2,294	(17,733)
(4,656)	Transfers to/from Other Reserves	(3,947)	–	(3,947)
(45,512)	Closing General Fund and HRA Balance	(56,941)	(10,251)	(67,192)

69.499	Opening general fund and HRA balance	71.617
2.118	Less/plus surplus or (deficit) on general fund and HRA balance in year	(13.080)
71.617	**Closing general fund and HRA balance at 31 March ***	**58.537**

* - For a split of this balance between the General Fund and the HRA – see the **Movement in Reserves Statement**.

Position of the EFA

28. The accounting code requires councils to give the EFA due prominence in the financial statements in accordance with the needs of users. 22 councils interpreted this requirement in 2016/17 as necessitating the EFA being presented as a separate financial statement.

29. However, clarification has been added to the 2017/18 accounting code that the EFA should be a note.

Include the EFA in a prominent position within the notes.

Cross-reference to further analysis

30. Part 2 of this good practice note discusses disclosures that support the EFA. This includes a note which analyses the adjustments in column 2. Where the EFA is included in the accounts as a financial statement it is helpful to users if a reference to that note is included at column 2 (see Exhibit 3 for an illustration).

31. Of the 18 councils who included the EFA as a financial statement with a separate note, only 11 included a note reference on the face of the EFA. Four councils who include the EFA as a statement included details of adjustments as a footnote.

Include a reference to the separate note providing an analysis of the adjustments column.

Part 2
Disclosures supporting the EFA

Key messages

The description of adjustments between a funding basis and accounting basis should be supported by narrative explanation.

The total adjustments should be consistent with the total adjustments reported elsewhere in the annual accounts, or an explanation for the difference should be disclosed.

The EFA should provide a bridge between the information in the management commentary and the figures in the financial statements

Description of adjustments

33. Councils are required to disclose a note to the EFA which describes the material adjustments between a funding and accounting basis included in column II of the EFA. Adjustments include those where the amounts chargeable to the general fund and HRA under regulation for funding purposes differ from amounts charged to the financial statements under IFRS.

34. The accounting code allows the adjustments to be aggregated. Most councils disclosed a note that aggregated the adjustments under the headings of capital, pension and other (typically including items relating to financial instruments and accrual of holiday pay).

35. A few councils included additional columns in their adjustments note for items of local significance. It is likely that users of the accounts found that information to be of interest as it makes the disclosure more council-specific.

36. Exhibit 7 shows a good example of a clear and concise adjustments note.

Exhibit 7

Note 4 Notes to the Expenditure and Funding Analysis Statement Adjustments between funding and Accounting Basis

Adjustments from General Fund to arrive at the Comprehensive Income and Expenditure Statement

	2016/17			
	Adjustments for Capital Purposes (Note a) £000	Net change for the Pensions Adjustments (Note b) £000	Other Differences (Note c) £000	Total Adjustments between Funding and Accounting Basis £000
Community and Enterprise Resources	13,973	995	(5,067)	9,901
Education Resources	50,230	(2,493)	(24,692)	23,045
Finance and Corporate Resources	661	1,171	(1,040)	792
Housing and Technical Resources				
- Housing Revenue Account	14,898	478	(9,251)	6,125
- Housing Other	2,031	722	(166)	2,587
Social Work Resources	598	4,297	(497)	4,398
Joint Boards	–	–	–	–
Non-Distributed Costs - Non Operational Assets (HRA)	–	–	(97)	(97)
Net Cost of Services	**82,391**	**5,170**	**(40,810)**	**46,751**
Other Income and Expenditure from the Expenditure and Funding Analysis	(77,113)	19,579	34,625	(22,909)
Difference between General Fund surplus or deficit and Comprehensive Income and Expenditure Statement surplus or Deficit on the Provision of Services	**5,278**	**24,749**	**(6,185)**	**23,842**

Aggregate the adjustments in a way that is specific to the council and helpful to users.

Supporting narrative

37. In order to meet the accounting code's requirements to *describe* the material adjustments, it is expected that some supporting narrative explanation should be provided. Without an explanation of the adjustments between a funding basis and an accounting basis, some users will struggle to gain a proper understanding of the accounts. Exhibit 8 shows an example of a helpful supporting narrative.

Narrative commentary helps users understand the adjustments.

Exhibit 8

1) Adjustments for capital purposes – this column adds in depreciation and impairment and revaluation gains and losses in the services line, and for:

- **Other operating expenditure** – adjusts for capital disposals with a transfer of income on disposal of assets and the amounts written off for those assets.
- **Financing and investment income and expenditure** – the statutory charges for capital financing ie Minimum Revenue Provision and other revenue contributions are deducted from other income and expenditure as these are not chargeable under generally accepted accounting practices.
- **Taxation and non-specific grant income and expenditure** – capital grants are adjusted for income not chargeable under generally accepted accounting practices. Revenue grants are adjusted from those receivable in the year to those receivable without conditions or for which conditions were satisfied throughout the year. The Taxation and Non Specific Grant Income and Expenditure line is credited with capital grants receivable in the year without conditions or for which conditions were satisfied in the year.

2) Net change for the removal of pension contributions and the addition of IAS 19 Employee Benefits pension related expenditure and income:

- **For services** this represents the removal of the employer pension contributions made by the authority as allowed by statute and the replacement with current service costs and past service costs.
- **For Financing and investment income and expenditure** the net interest on the defined benefit liability is charged to the CIES.

3) Other differences between amounts debited/credited to the Comprehensive Income and Expenditure Statement and amounts payable/receivable to be recognised under statute:

- **For services** this represents the accrual made for the cost of holiday/leave entitlements earned by employees but not taken before the year-end which employees can carry forward into the next financial year. These require to be included within the Net cost of Services under generally accepted accounting practices, however are not chargeable to the General Fund.
- **For Financing and investment income and expenditure** the other differences column recognises adjustments to the General Fund for the timing differences for premiums and discounts.

38. However, only around a half of councils included any narrative description of adjustments made in 2016/17.

Include narrative explanation of adjustments between a funding and an accounting basis in the note supporting the EFA.

Consistency between the EFA and the MIRs

39. The EFA and the MIRS both include totals for adjustments between a funding basis and accounting basis. In the MIRS these are analysed between the general fund and HRA only, while the EFA analyses them by segment. It is expected that the total amounts should be consistent. However, if the totals are validly different, they should be reconciled so that users can understand why that is the case.

40. Our review found that in many cases the adjustments included in the EFA were different to those included in the MIRs. However, councils did not explain the difference.

Where adjustment totals included in the EFA differ from those included in the MIRS, explain the reasons for the difference in supporting disclosures.

In many cases it was not clear why adjustments included in the EFA were different to those included in the MIRS.

Linking disclosures supporting the EFA and MIRS

41. There is clear overlap between the EFA and the MIRS. Cross referring supporting disclosures, or positioning the disclosures together, can help

No cross references existed between disclosures supporting the EFA and MIRS adjustments.

the user of the accounts gain a better understanding of adjustments. It can also eliminate the need for any duplication of narrative.

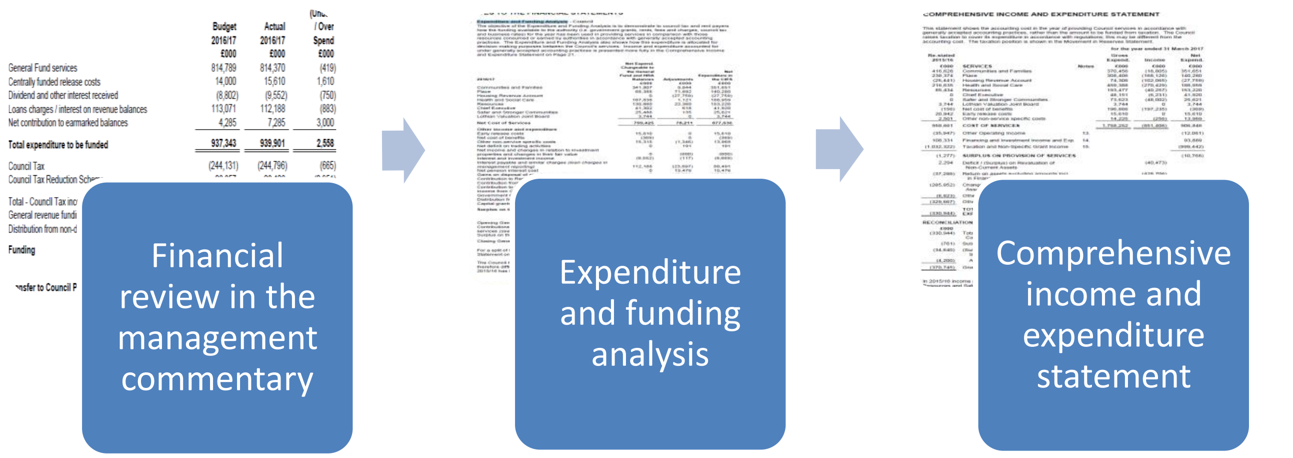
42. Our review of the 2016/17 annual accounts found that no councils cross referred between disclosures supporting the EFA and MIRS, although in some cases notes were positioned together.

Cross-refer disclosures supporting the EFA and the MIRS where that eliminates the need for duplication of narrative.

Bridging management commentary and financial statements

43. The EFA should provide a link between the council's internal reporting and the figures shown in their financial statements. To do this effectively, the EFA should be used to provide a bridge between the management commentary and the CIES as shown in Exhibit 9.

Exhibit 9



Linkages with business review and the EFA

44. The management commentary is required to include a fair review of the council's business. This should be a balanced and comprehensive analysis of the council's development, performance and position.

45. The accounting code recommends that a council should cross-refer in the management commentary to the outturn provided in the EFA and include additional narrative context for the performance the EFA presents. It also states that a council may wish to include appropriate budgetary information to provide additional context to the EFA.

46. One reason for introducing the EFA was to better connect the figures in the CIES with those that are reported in budget reports for internal management purposes. The value of the EFA is enhanced when column I in the EFA is recognisable to the user of the accounts, particularly

It may be helpful to ensure that the 'bottom line' for outturn reporting purposes is the true movement in reserves shown in the accounts.

elected members. A good way to meet this objective is to ensure that column I agrees to (or is reconciled with) the budget outturn position reported to members.

47. It is helpful to users of the accounts if the council's business review included in the management commentary shows the budget outturn and movement in reserves in a way that is consistent with the analysis in the EFA. Any adjustments to the figures in the management commentary should be clearly explained, together with the reasons why they are being made.

48. Exhibit 10 includes an example of a management commentary illustrating how the budget outturn links to the EFA.

Exhibit 10

Management Commentary

Telling the Story

These Annual Accounts incorporate the "Telling the Story" presentational changes included in the 2016/17 Local Authority Code of Practice (the Code), and include a new statement, the Expenditure and Funding Analysis (EFA) and associated note which are on pages 14 and 15. The EFA provides a link between the East Ayrshire Performs (EAP) budget management reports and the figures in the main financial statements. The reconciliation below has been included to assist users of the Accounts in navigating from the East Ayrshire Performs year end financial management report through to the first column of the EFA on page 14 and to the CIES on page 18.

	East Ayrshire Performs			Building the EFA					EFA Column 1
2016/17	Annual Budget	East Ayrshire Performs Outturn	Variance (favourable) / adverse	East Ayrshire Performs Outturn	Movements Contribution from Health & Social Care	Movements - amounts not included within Net Cost of Services	Net Expenditure chargeable to the General Fund & HRA Balances	EFA Segment	Net Expenditure chargeable to the General Fund & HRA Balances
	£m	£m	£m	£m	£m	£m	£m		£m
Central Mgt Support Economy and Skills	0.746	0.349	(0.397)	0.349	-	-	0.349	Economy and Skills Other Segments	1.705
Policy Planning and Performance Division	1.381	1.356	(0.025)	1.356	-	-	1.356		
Debt Charges	21.715	21.715	-	21.715	-	(21.715)	-	Central Services	5.933
Council Tax	(51.414)	(51.320)	0.094	(51.320)	-	51.078	(0.242)		
HB/ CT Benefit Subsidy	10.106	9.721	(0.385)	9.721	-	(8.618)	1.103		
Government Funding	(230.091)	(230.087)	0.004	(230.087)	6.210	223.877	-		
Balance Brought Forward	(10.254)	-	10.254	-	-	-	-		
Reserve Transfers	(3.175)	(1.875)	1.300	(1.875)	-	1.875	-		
Net Cost of Services (EFA Column 1)	-	**1.263**	**1.263**	**1.263**	-	**246.497**	**247.760**		**247.760**

Note 1 The £6.210m shown in the column headed "Movements - Contribution from Health & Social Care" represents the Council's share of funding from Scottish Government that was first allocated to NHS Ayrshire and Arran prior to being transferred to the Council.

Note 2 The figures in the column headed "Movements - amounts not included within Net Cost of Services" predominantly relate to taxation and non specific grant income and as such are reflected in the appropriate sections of the EFA and the CIES (below Net Cost of Service) in line with the presentational requirements of the Code.

Ensure that column I of the EFA is reconciled from the business review in the management commentary.

49. It may be helpful if budgetary information includes not only the outturn but also the original budget and any variance (see the first and third columns Exhibit 10 as an example).

Consider including the budget for each service in the management commentary.

Part 3
Other segmental reporting disclosures

Key messages

A subjective analysis of income and expenditure should be disclosed.

Service income analysed by operating segment should be disclosed.

Expenditure and income analysed by nature

50. Councils are required to disclose information on the nature of their expenditure and income across subjective headings recommended by the accounting code. Headings include employee benefits expenses, for example, which is an area of interest to stakeholders such as the Accounts Commission at a time when council plans include severance.

51. Our review found that almost two thirds of councils included an analysis of expenditure and income by nature. Exhibit 7 shows an example. However, the remaining councils did not provide this information that users may have found helpful.

More than a third of councils did not include an analysis of expenditure and income by nature.

Exhibit 11

Note 5 Expenditure and Income Analysed by Nature

Where items are not disclosed on the face of the Comprehensive Income & Expenditure Statement (CIES), *The Code* requires a disclosure of the nature and amount of material items. An analysis of material items of income and expenditure by nature is shown below:

	2016/2017	2015/2016
Expenditure	£000	£000
Employee Benefits Expenses	114,939	114,328
Depreciation, Amortisation, Impairment	16,996	25,006
Payment to IJB	48,815	0
Other Service Expenses	136,572	150,161
Interest Payments	17,581	18,718
(Gain) or Loss on the Disposal of Assets	(351)	(245)
Total Expenditure	**334,552**	**307,968**
Income		
Fees, Charges and Other Service Income	(41,434)	(52,447)
Payment from IJB	(48,815)	0
Income from Council Tax and Non-Domestic Rates	(28,388)	(27,730)
Government Grants and Contributions	(215,691)	(230,784)
Total Income	**(334,328)**	**(310,961)**
(Surplus)/Deficit on the Provision of Service	**224**	**(2,993)**

52. Where relevant, segmental reporting disclosures are also required for the group accounts. However, only three councils included an analysis of the nature of expenditure and income which included their subsidiaries.

Include a note to the accounts showing an analysis of expenditure and income by nature.

Service income by operating segment

53. The accounting code also requires a segmental analysis of a range of items where they are included in the EFA. A number of these items are effectively covered by the adjustments note supporting the EFA. However, one key area not shown elsewhere relates to service income.

54. Service income is of increasing interest to stakeholders in this period of austerity, as income maximisation often forms part council plans to close funding gaps.

55. Our review identified that only a quarter of councils included an analysis of service income by operating segment in 2016/17. Exhibit 12 provides an example.

Service income is of increasing interest as income maximisation often forms part of plans to close funding gaps.

Exhibit 12

Income received on a segmental basis is analysed below:

Services	2015/16 Income from Services £'000	2016/17 Income from Services £'000
Chief Executive	(5,657)	(5,905)
People	(17,449)	(68,323)
Place	(15,363)	(17,919)
Other	(31,219)	(32,913)
Non Distributed Costs	-	-
Total income analysed on a segmental basis	(69,688)	(125,060)

Include an analysis of service income by operating segment in the notes

56. A number of councils who had satisfied this disclosure requirement had done so by adopting a matrix approach to their disclosure of expenditure and income by nature. Exhibit 13 shows one such disclosure.

Exhibit 13

Note 8 Expenditure and Income Analysed by Segment and Nature

The authority's expenditure and income is analysed as follows:

Income and Expenditure 2015/16

	Educational & Integrated Children's Services £000	General Services Housing & Property Services £000	Direct Services £000	Development Services £000	Corporate Services £000	Chief Executive £000	Other Services £000	Health & Social Care £000	Housing Revenue Account £000	Costs not included in a Service £000	**Total £000**
Employee expenses	68,274	8,173	18,876	4,341	10,176	1,820	32	18,709	2,379	3,369	**136,149**
Other service expenses	28,984	9,428	19,896	2,127	20,283	443	1,063	33,937	8,655	-	**124,816**
Depreciation, amortisation and impairment	8,205	1,416	9,152	92	1,068	8	51	154	12,689	328	**33,163**
Interest Payments	-	-	-	-	-	-	-	-	-	11,789	**11,789**
Loss on Disposal of Non Current Assets	-	-	-	-	-	-	-	-	-	6,141	**6,141**
Total Expenditure	**105,463**	**19,017**	**47,924**	**6,560**	**31,527**	**2,271**	**1,146**	**52,800**	**23,723**	**21,627**	**312,058**
Fees, charges & other service income	(2,629)	(11,758)	(13,776)	(1,840)	(18,398)	(161)	(162)	(10,650)	(16,757)	-	**(76,131)**
Interest and investment income	-	-	-	-	-	-	-	-	-	(256)	**(256)**
Income from council tax	-	-	-	-	-	-	-	-	-	(35,447)	**(35,447)**
Government grants and contributions	(1,912)	(2,071)	(179)	(300)	(657)	(23)	-	(390)	-	(180,325)	**(185,857)**
Total Income	**(4,541)**	**(13,829)**	**(13,955)**	**(2,140)**	**(19,055)**	**(184)**	**(162)**	**(11,040)**	**(16,757)**	**(216,028)**	**(297,691)**
Net Expenditure	**100,922**	**5,188**	**33,969**	**4,420**	**12,472**	**2,087**	**984**	**41,760**	**6,966**		
(Surplus) or deficit on the provision of sevices											**14,367**

57. Matrix style disclosures can be transposed to show operating segments in column I and the nature of expenditure and income in the top row where the council has a large number of operating segments.

58. A matrix style disclosure showing the nature of expenditure and income by operating segment provides a fuller analysis, and may be of greater interest to stakeholders than separate disclosures showing total expenditure by nature and service income by segment.

Consider the benefits of a full analysis of the nature of expenditure and income by operating segment.

Appendix 1
Improvement checklist

The following checklist is intended to assist councils improve the quality of annual accounts in relation to the EFA.

Page no.	Issue	Yes	No
7	Have you provided clear explanation of the purpose of the EFA that is specific to the council?		
9	Have you reported operating segments at an appropriate level of aggregation?		
10	Where internal recharges have been eliminated in columns I and III of the EFA, have you provided a sub total for segmental income and expenditure?		
11	Have you included the EFA in a prominent position within the notes?		
11	Have you provided a clear reference from Column II of the EFA to the note that provides an analysis of that column?		
12-13	Have you aggregated the adjustments in the supporting note in a way that is specific to the council and helpful to users?		
13-14	Have you supplemented the analysis of the adjustments with a helpful and clear narrative explanation?		
14	Have you explained the reasons for any difference between the total adjustments in the EFA and in the MIRS?		
14	Have you considered whether cross-referring between the disclosures supporting the EFA and the MIRS eliminates the need for duplication of narrative?		
15-16	Have you ensured that the business review in the management commentary reconciles to column I of the EFA?		
17	Have you considered including the budget for each service in the management commentary.		
18-20	Have you disclosed an analysis of expenditure and income by nature and service income by operating segment?		
20	Have you considered the benefits of a full analysis of the nature of expenditure and income by operating segment?		

Appendix 2

Characteristics of good annual accounts

A single story

1 The narrative in the management commentary and annual governance statement should be consistent with the accounting information in the financial statements.

2 Significant points in the financial statements should be explained in the management commentary.

How funding was used

3 The management commentary should give a clear and balanced account of how funding was used.

4 Explanations of the local authority's business model should be provided.

5 The salient features of the local authority's performance and position should be explained in a balanced way.

What worries elected members

6 The risks and uncertainties described in the management commentary should genuinely be the principal risks and uncertainties that the elected members are concerned about.

7 The descriptions should be sufficiently specific that users can understand why they are important to the elected members.

8 The management commentary and annual governance statement should describe the mitigating actions to manage the impact of the principal risks and uncertainties and significant governance weaknesses. The links to accounting estimates and judgements should be clear.

Consistency

9 Highlighted or adjusted figures, key performance indicators and other measures referred to in the management commentary should be clearly reconciled to the relevant amounts in the financial statements.

10 Any adjustments to the figures in the management commentary should be clearly explained, together with the reasons why they are being made.

Cut the clutter

11 Important messages, policies and transactions should be highlighted and supported with relevant context and are not obscured by immaterial detail.

12 Cross-referencing and signposting should be used effectively, and repetition avoided.

Summarise

13 **Items should be reported at an appropriate level of aggregation.**

14 **Tables should be supported by, and consistent with, the accompanying narrative.**

Explain change

15 **Significant changes from the prior period, whether matters of policy or presentation, should be properly explained.**

True and fair

16 **The spirit as well as the letter of proper accounting practices should be followed.**

Good practice note on improving the quality of local authority annual accounts – expenditure and funding analysis

If you require this publication in an alternative format and/or language, please contact us to discuss your needs: 0131 625 1500 or **info@audit-scotland.gov.uk**

For the latest news, reports and updates, follow us on:

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: 0131 625 1500 E: